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ORE-VISION

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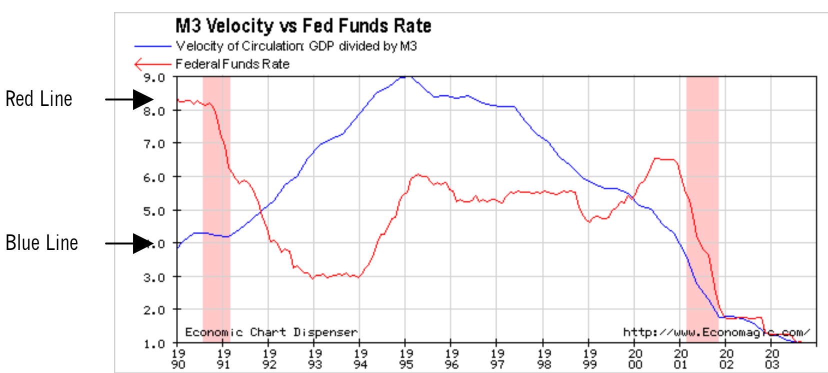
Where Did The Money Go?

David Chuhran

After doing the research for my last 2 editorials I started thinking (scary thought, I know), "Where did all the money go?".

The last thing I wrote about was the impact the velocity of money and the Fed Funds Rate had on the money supply. I discussed it in the broadest terms and I don't intend to go any deeper because I think the answer lies close to the surface. I went back and looked at some combinations in an attempt to figure out the answer to my question. The first chart shows M3 Velocity against the Fed Funds Rate. Again, M3 Velocity is basically the speed at which the broadest measure of money supply circulates and is turned over creating economic activity. This gives you a rough idea of the temperature of the economy. The Fed Funds Rate, as discussed before, is the short term interest rate the Fed uses as the gas pedal or brakes to control the economy. I took a look back before the last recession (shown in gray shading) to the present. The left scale shows interest rates. I removed the M3 Velocity scale because the numbers were irrelevant, but the line itself speaks volumes about the trend.



First, notice that interest rates were up above 8% (red line) in 1990 as we entered a recession. The Fed, realizing the economy needed stimulus, pushed on the gas pedal by dropping interest rates by over 5% in 2 years. Notice the corresponding rise in the M3 velocity (blue line) as it responded to the Fed's foot pushing on the gas pedal. As a matter of fact, M3 responded so well that the economy began to get too hot, so in '94 the Fed began braking to slow the economy down by raising rates back to 6% over the course of the year. See how that rate hike flattened out the M3 velocity through mid '97. Rates were kept in the 5-6% range all the way through the tech bubble run-up while the M3 velocity continued on a steady decline. About mid '99 the Fed decided to put the brakes on again by hiking rates just under 2% over the next year. It's apparent to me that it wasn't due to an overheated economy, but more likely due to an overheated stock market. The Nasdaq topped out in March 2000

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Forecast 2004

David Chapman

T'is the season to be jolly and jolly this past year has been. As one pundit declared that if you didn't make money in 2003 then fire your broker. Everywhere it has been green. So green in fact that it is enough to make you forget about 2000-2002. So just how green has it been? The TSX Composite is up 20%, the Dow Jones Industrials (DJI) 20%, the S&P 500 21.7% and leading the way the NASDAQ up 45%.

But in some individual sectors the gains have been even better. The sub indices of the TSX saw gains of 17% for the energy index, 17% consumer discretionary, 13% consumer staples, just under 22% for financials, 13% for Golds although they are up 54% from the March lows, 10% health care, 19% for income trusts, 16% industrials, 7% information technology, 19% for the materials index, a stellar 33% for real estate, 30% for telecommunications, 19% utilities, and the top performer metals and mining up 49%. Of course the Canadian Dollar was up 18% against the US$ (thus wiping out any gains if you were Canadian and invested solely in the US market) and commodities as measured by

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the CRB Index were up 10% to help the Canadian mining sector.

The markets managed to avoid four years in row down. That was last accomplished during the Great Depression with the dismal record of 1929-1932. We had noted in last year's forecast that years ending in 3 tended to be positive years. So in that respect 2003 did not disappoint. We were struck by the similarity of 2003 with both 1933 (70 years) and 1978 (25 years). We had noted last year that the 1978 cycle in particular as "this one bears watching". In 1978 the market was hard down into March then was followed by a strong rally into October. 1933 as well was down into March then rallied back into July before basically just chopping around for the balance of the year.

And so it was with 2003 with a hard down into March and while we acknowledged that new lows were possible that we thought if the "October (2002) lows were good then we will at worst see a severe test of these lows". Themes we thought would dominate in 2003 were Golds and energy. Golds, after getting through a severe shakeout in the first quarter did not disappoint and they led the way the rest of the year. While energy was not as strong it still put in a decent performance. The quick conclusion to Gulf War II played a role in bottoming the market in March coupled with the ongoing easy money policies of the Federal Reserve and another sharp increase in debt of all kinds.

So now we turn to 2004 and since it is a Presidential election year there

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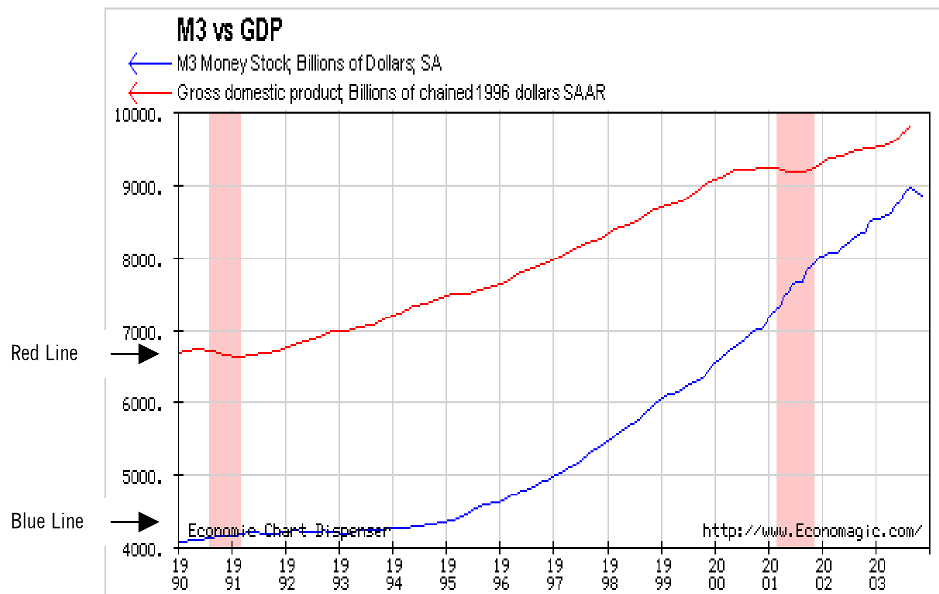
with the SnP following it down later in the year. Look at the end of 2000 where the Fed began the first of 13 rate cuts in a desperate attempt to stop the stock market's decline and also to reignite the economy as we entered another recession. Notice how they put the gas pedal all the way to the floor and the M3 velocity continued to drop. It failed to respond to this traditional stimulus, so what was going on?

I needed to look further and decided to look at M3 against GDP. I wanted to see if I could find any relationship between the broadest measure of the money supply (M3) and our Gross Domestic Product. We had obviously, by definition, exited the recession, but the economy seemed to be languishing. You have to ask yourself, "If the recession was over in 2001, then why is everyone still talking about the recovery 2 years later?" It just seems like an awful long time to be recovering while the TV analysts are trumpeting the new Bull. It just doesn't make any sense, so here's what I found.



Taking a look back to the beginning of 1990 notice how flat M3 remained all the way through 1995. There was a $300 billion rise in M3 over those 5 years with a corresponding $770 billion rise in GDP. In other words, it took a 38 cent rise in M3 to generate a $1 rise in GDP. That seems like a pretty reasonable return, but then everything changed and I can't really pinpoint the exact point, time, or event and I can't say with certainty that it was directly related to the change in Treasury Secretary. I'll let you draw your own conclusions there. Nevertheless, in mid '95 the dynamics changed. Between March '95 and March 2000, we experienced a $2.3 trillion rise (~+50% in 5 years, WOW!) in M3 while we only gained $1.6 trillion in GDP. What? Now it took a $1.43 rise in M3 just to get a $1 rise in GDP. That's quite a turnaround. You can visually see the convergence in the chart showing that it was taking more and more growth in the money supply to generate the same rise in GDP.

This bothered me and it appeared to get worse as we approached the point where the Nasdaq began its decline. I noticed a flattening in GDP growth while M3 began a steeper climb, so I expanded that period to get a better look.

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are numerous pundits led by a certain US major brokerage analyst whose past record should have had her fired years ago but nonetheless is predicting that the S&P 500 will tack on another 17% again next year. But like the fools on the Titanic she is probably going to take a lot of innocent people down with her. Like the bubble of the late 1990's that culminated in 2000 we once again have the Federal Reserve leading the way with low interest rates, easy money and easy credit. So if we see a positive economy and a rising market just remember that it is built on an illusionary foundation that will crumble like a house of cards when the time is right. Just because it hasn't happened doesn't mean it won't it just has to wait the right time in the cycles. And when it does crumble it will take no prisoners.

For years I have been a fan of Michael Jenkins of Stock Cycles Forecast. I confess I can't hold a candle to him but I have learned hopefully something about cycles and have discovered that they do work but they are certainly never perfect. So with that knowledge we always like to look at the decennial cycles which in some form tend to repeat themselves over and over again often with similar themes dominating. Technical analysis is all about pattern recognition and patterns repeat themselves constantly so it is a case of looking for those repetitions.

Over the past 100 years there have been 5 elections in years ending in 4, 1904, 1924, 1944, 1964 and 1984. It was almost perfect as 1904, 1924, 1944 and 1964 put in up years with only 1984 acting as a spoiler with a down year. But we couldn't help but notice that 1903 and 1923 were down years, 1943 was up but it peaked by June and then spent the rest of the year falling, 1963 was the beginning of the great 1960's bull market coming out of a steep decline in 1962 so it was a strong up and 1983 was also a strong up year coming out of the early 1990's recession and market pause. With the exception of 1963/1964 then the market tended to do the opposite in the election year then what it did the year before.

This symmetry of opposites for election years ending in 4 is something worth noting as we go into the New Year. Over the past 100 years six years ending in 4 were up years while four were down years. Most notable up years were 1904 (100 years), 1924 (80 years), 1954 (50 years) and 1964 (40 years) the latter two during the great early years of the Kondratieff Spring while the most notable down years were 1914 (90 years - the market was suspended due to the war) and 1974 (30 years - a year notable for a devastating bear market) and both came during Kondratieff Summers. The remaining years 1934 (70 years), 1944 (60 years), 1984 (20 years) and 1994 (10 years) were generally flat years not being either up too strong (1934 and 1944) nor down too strong (1984 and 1994).

One characteristic we did note that with the exception of the strong directional years of 1954, 1964 (both up) and 1974 (strong down) the markets tended to be weak into the first quarter sometimes stretching to the second quarter and stronger in the latter part of the year. One final characteristic that was also noted that with the weakness seen in many of the years in the first half of the year the high was made almost in January and no matter whether it was bull or bear years. The exceptions were the powerful bull markets of 1954 and 1964 where it was lows that were made in January and 1944 which had a strong first half with a low in November/December 1943. If the high for this cycle does not come in December it will come in January.

The other cycle worth mentioning is the 25 year cycle, which as we noted, appeared to be the dominate cycle this year. 1979 was dominated by themes of rising commodity prices, sharply rising gold prices, rising energy costs, a falling US Dollar and falling bond prices (yields rising). Curiously we see these themes as being dominate again for 2004. While overall the market was generally flat for the year (1979) it was notable for a sharp decline in the first quarter, a rally into April followed by a shallower decline

into the summer then a good rally into October that culminated in an 11% decline into October/November a soaring gold market and a devastating bond market collapse in conjunction with the falling US Dollar.

America has become the land of illusion where real jobs are scarce dominated as it is with McJobs and Wal-Mart greeters and the industrial sector increasingly hollowed out with jobs migrating primarily to China and India. Even former solid white collar jobs in software and technology call centres are migrating to India. Malls seem to be in endless sales where 50% off not only seems normal its high, cars are 0% financing and the average American household owns 2.4 cars most likely gas guzzling SUV's. Everyone has mortgaged their houses to the hilt expecting the housing boom to never end and instead of using the mortgage funds, often to 110% of market value, to pay down debt it is used to buy more televisions, cars and electronic equipment. Corporate profits are razor thin as everyone has to compete with Wal-Mart.

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If the US$ dollar wasn't falling to compensate for the decline, oil and other commodity prices would probably rise anyway as demand soars in China and India. The mortgage companies led by Freddie Mac and Fannie Mae, despite record mortgages being handed out, are also regularly recording record delinquencies and bankruptcies just keep on going up never down. What does one expect with record debt and a record debt bubble.

If there is one bright spot it is here in Canada and other places where junior mining and junior oil and gas companies are raising record amounts of cash with the high gold and other base metal commodity prices and rising oil and gas prices. That ensures that there will be a lot of drilling going on next year and we suspect that a boom in these junior resource companies that could last 2 to 3 years is just around the corner. That doesn't mean there can't be drops in the price of gold and other base metals and subsequent weakness in the companies but if the weakness in the markets comes in the first quarter as we suspect then that may be the time that these companies experience weakness as well. But signs of strong accumulation have been going on for months and any weakness will be an opportunity to accumulate further.

It would be nice to think that the market rise in 2003 will continue into the election year of 2004. But evidence does not support this especially for the first half of the year. If the pullback is normal it will correct at least 2/3's of the up move but if we were to return to

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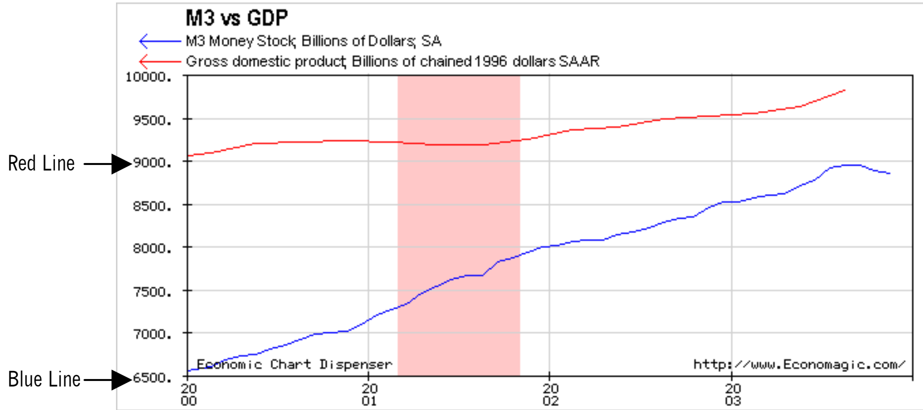

Between the Nasdaq top in March 2000 and the end of the recession (gray shaded area) we only grew GDP by $90 billion while M3 grew by another $1.2 trillion. Remember, this was period of time where the Fed initiated most of the 13 rate cuts while M3 velocity was plunging and failing to respond to that Fed stimulus. Over these 18 months it took a M3 growth of $13.33 to achieve a $1 rise in GDP. That M3 growth was not translating into growth in the GDP. Much of that growth in M3 must have been pure liquidity injections by the Fed and while the GDP growth has resumed a modest climb, the M3 growth rate is still disproportionately high. I do realize that we had 8.2% GDP growth in the last quarter, but that still isn't enough to account for the rapid rise in M3 while GDP remained relatively flat in prior quarters.

So, where did the money go?

It's my belief that since the unprecedented increases in M3 continued to show diminishing returns in GDP growth, and while the Fed had the low interest rate gas pedal to the floor with a plunging M3 velocity, I can only surmise that the additional money supply found its way into the stock market fueling the current bear market rally. Lastly, notice the tail end reversal of M3. That's contraction of the money supply. With interest rates at 1%, M3 velocity grinding to a halt, and the pure liquidity injections failing to hold up M3, I believe we will see an outflow from the equity markets unless that trend can be stopped and M3 growth resumes. I don't believe they can stop it without completely debasing the dollar and risking its total collapse, therefore I believe that once the equity market outflow begins it could be quite severe.

Debt Illusion!

David Chapman

We live in a world of illusion. With all due respect to magicians, illusionists and Hollywood techno wizardry our biggest illusion seems to be debt and its eventual impact. Here are some interesting numbers. To the end of the second quarter 2003 US GDP rose $417 billion from $10,376.8 billion to $10,793.8 billion or 4% from the second quarter 2002 (all numbers from the most recent Federal Reserve Flow of Funds Accounts of the United States). Debt, however, grew in the same period from $19,941.3 billion to $21,597 billion for a rise of $1,655.7 billion (8.3%). A ratio of 4:1 of Debt: GDP.

But even the GDP numbers were an illusion as are many other numbers that are reported on a regular basis. In a fascinating article by Jim Puplava of Financial Sense (www.financialsense.com) (The OK' (but fictional) Economy - September 12, 2003) he outlined numerous other areas of illusion.

With GDP he pointed out how defence spending made up over 55% of GDP growth in the 2nd quarter 2003 an item driven by the Gulf War II and not likely to be sustained; how business spending was overstated by $32.1 billion in the same quarter; how the debt numbers that are reported on the Federal Reserve Flow of Funds above are understated as they do not include unfunded liabilities such as Medicare, Social Security, Medicaid and Pensions; and, how unemployment is consistently underreported as it ignores those that have given up looking, not on unemployment insurance, those that don't apply for benefits or whose UI has expired. The real unemployment rate in the US is probably closer to 10% or higher which would actually make it higher than here in Canada that does count many of those categories not reported in the US.

And the illusion extends beyond the numbers reported by the Government. Corporations continue to report earnings based on pro forma rather than the GAAP earnings that would be at least 40% lower. There is also a large gap between what is reported on annual reports and to the public versus what is reported for tax purposes. This illusion feeds into the stock market where the story of increasing earnings is being bought.

The US now has triple deficits of budget, trade and current account (for us Canadians we currently have surpluses in the big three). The budget deficit is estimated to be $525 billion in the upcoming year. That requires $1.4 billion a day to finance. Similarly the trade and which is also nearing $500 billion requires similar flows daily to finance. And these flows are dependent on foreigners supplying the funds. As well there is a growing and worrisome current account deficit telling us that US savings are now substantially lower than investment in the US including investments by foreigners.

The US has managed to maintain flows as many countries especially in Asia are concerned about the value of their currency and as a result they have recycled the US dollars obtained through exports back into purchasing US debt Securities. It is estimated that foreigners have over $0% of the US debt and of that Asians countries hold an estimated $1.3 trillion of debt. At one time the US was a significant world creditor but now they have become the world's largest debtor. The total debt to GDP ratio based on the Flow of Funds is now over 2:1 and when the unfunded liabilities are taken into consideration it is over 3:1. Federal Government debt similarly is 36% of GDP based on reported numbers in the Flow of Funds but with the unfunded liabilities is 63% of GDP.

But if the government debt is considered a problem then all should be alarmed about consumer debt and the lack of consumer savings. The consumer makes up roughly 75% of the economy. But consumer debt has been rising at an alarming rate. Over the past year the biggest debt growth was

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The Emperor Has No Clothes

Kurt Richebächer

Americas economic recovery and its likely strength have been and remain the central preoccupation in economics around the world.

In the consensus view, the U.S. economy will record in this year's second half its strongest pace of growth since the late 1990s. According to a monthly survey of 53 economic forecasters conducted by the Wall Street Journal Online, its seasonally adjusted annual growth rate during the current quarter will be 4.7% and 4% in the fourth quarter.

While a few economists have been warning that this recovery's actual pace may disappoint, our own view is that the U.S. economy's higher growth rate in the second quarter was totally deceptive. Focusing strictly on the hard economic data, like employment, personal income, production, business fixed investment and profits, we completely fail to see any recovery at all in the United States.

Ever since 2001, the United States has been running monetary and fiscal stimulus of unprecedented largess. In July, the government's tax cut and rebate checks turned an income gain of $19 billion into a $120 billion gain in disposable income.

In the bullish consensus view, the medicine is finally working. Above all the upward revision of the second-quarter real GDP growth rate from 2.4% to 3.1%, following 1.4% each in the two prior quarters, has caused virtual euphoria.

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Consumer Purchases

Toyota Camry
Sticker price, plus destination charge, for base model
2001: $18,130 – 2003: $19,455

Unleaded Gasoline
Average national price per gallon for all grades combined, including all taxes; self-service
2001: $1.49 – 2003: $1.61

Tax Preparation
Average cost of federal, state and local tax-return preparation by H& R Block
2001: $111.65 – 2003: $130.59

Hospital Stay
Average cost of one day in a semiprivate room, including ancillary services
2001: $2,854 – 2003: $ 3,889

McDonald's Big Mac
Average recommended price
2001: $2.54 – 2003: $ 2.71

Movie Ticket
Adult ticket, first-run theater, in the evening
2001: $7.50 – 2003: $ 8.50

Birth
Average hospital cost for mother and child, excluding private physician's fee
2001: $5,554 – 2003: $6,696

A Year in College
In-state, including room and board, for an undergraduate student at Penn State University
2001: $12,354 – 2003: $14,736

Funeral
National average, excluding cemetery costs. Estimate, Federated Funeral Directors of America
2001: $5,980 – 2003: $6,375

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Knowing these are annualized growth rates is the first reason why we are still unable to see a sustained, let alone a self-sustaining, economic recovery in the United States. When American economists speak of 4% growth in the coming quarters, they really mean 1%, and that is a far cry from what used to rank as a cyclical recovery. Growth rates of postwar recoveries in the United States averaged 5.4% over the first two years after recession - and that needed very little monetary and fiscal stimulus, as against less than 3% growth currently. The second reason for our disbelief is that U.S. GDP has been heavily bolstered by government spending. In the fourth quarter of 2002, it accounted for 24.5% of nominal GDP growth, in the first quarter of 2003 for 40.7% and in the second quarter for 38.2%. A third reason is that the recovery completely fails to show in the current-dollar data. In these dollars in which all economic activity takes place, GDP grew 0.99%, after 0.94% in the first quarter, an acceleration hardly worth mentioning. But measured in chained dollars, it more than doubled from 0.35% to 0.775%. Taking the big boost from government spending into account, it was more slowdown than acceleration. The fourth and most important negative point is that the trumpeted recovery in business fixed investment, in particular in high tech, is just another statistical mirage. In the second quarter of 2003, overall business fixed investment in structures, equipment and software, measured in current dollars, amounted to $1,119.9 billion, slightly down in comparison with $1,126.8 billion in the first quarter of 2002. Measured in real terms, chained dollars, it was up $64 billion, or 0.5%. I hardly need remind you that a true economic recovery essentially must come from a balanced rise in consumer spending and business investment spending. But what really happened to the two during the first half of 2003, being generally hailed as the start of the U.S. economy's final recovery?

Let us look at the changes in aggregate GDP. Measured in current dollars, it grew by $99.6 billion in the first quarter and by $105.5 billion in the second quarter, hardly an acceleration.

Looking at the demand components, growth of consumer spending, its biggest component, slowed between the two quarters from $87.1 billion to $83.1 billion. Nonresidential fixed investment dipped in the first quarter, but recovered in the second quarter to its earlier level. From first to second quarter, the growth of government spending slowed from $40.7 billion to $33.6 billion, and that of residential investment from $21 billion to $6 billion. Not one single GDP component rose. The sharply rising trade deficit subtracted $11.1 billion from GDP growth in the first quarter and $23.8 billion in the second.

But this dismal picture, measured in current dollars, radically changed for the better after the statisticians had treated the numbers with their price indexes. GDP growth, measured in chained dollars, surged from $33.8 billion to $73.5 billion. Growth in consumer spending, down in current dollars, went steeply up from $33 billion to $62.4 billion, and growth in government spending even shot up from $1.7 billion to $31.7 billion.

Yet by far the single biggest contributor to this sudden surge in real GDP growth from the first to second quarter came from the calculation of the price deflator for computers. Measured in current dollars, this investment inched up by $0.8 billion in the first quarter and by $6.3 billion in the second quarter, but the hedonic deflator boosted the two numbers in real terms to $15.3 billion and $38.4 billion. Hedonic pricing of computers in the first quarter accounted for 43% of real GDP growth and for 44% in the second.

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in mortgage loans borrowed on the basis of rising house equity. Mortgage loans grew by 13.6% or $774 billion from the 2nd quarter 2002 to the 2nd quarter 2003. Consumer debt by comparison grew only 3.4 % or $65 billion in the same period.

Mortgage debt now represents over 45% of household real estate. This is up from 43% at the end of the 2nd quarter 2002. While this does not seem too bad it of course under represents many that job erosion and rising long term interest rates that will dampen the housing market. Recent numbers would seem to indicate that the housing market is cooling. Couple this with a low to non existent savings rate and any rise in the jobless coupled with a fall in the real estate market is courting a potential disaster.

Numerous pundits have declared that the debt is not a problem. That as long as the economy grows and the Federal Reserve remains prepared to supply endless liquidity the debt can be serviced. But we have noted that the Kondratieff winter cycle is all about cleansing the debt. That was certainly the case in the 1930's. But the 1930's was also a lot about trade wars that helped exacerbate the debt situation contributing to the collapse.

Today the trade wars are taking the form of currency wars. The long overvalued US Dollar has been falling since a final top in February 2002. Recent rallies only brought it back to key resistance levels. The attack is being led by the US who have been losing manufacturing jobs at a rapid pace throughout the 1990's. The jobs have largely migrated to the Asian economies particularly China. While the US would like to see a lower dollar to help their beleaguered trade and current account deficits the Asian economies want to maintain their competitive export advantage. As we noted above in order to help keep some restraint on their currencies from rising they have been buying US securities.

In the US it is estimated that upwards of 2.7 million manufacturing jobs have been lost in the last three years. This is causing great consternation in the halls of the senate and congress where wails of searching for a scapegoat get louder. Japan served as one in the past and today it is China. The recent Cancun Accord or, how some have dubbed it, the Dubai accord as it had its beginnings in earlier meetings in Dubai is designed to get try and get the Chinese to float their currency and the Japanese to strengthen theirs.

But wishful thinking is not sufficient to change what is a good thing for China but bad for the US. Nor is necessarily good as the huge imbalances of huge deficits in the US coupled with huge holdings of US securities in the hands of Asians particularly China and Japan and others has the potential to cause even more global currency instability. There have also been threats of tariffs and other measures if they do not cooperate. The recent Cancun trade talks collapsed because of the failure to come to agreements over tariffs. Even the esteemed Economist in their recent issue September 20th - 26th 2003 expressed alarm at the potential growing instability.

In a world where the world's largest economy lives in denial as their wealth sits not on a solid rock base but instead is supported by the shifting sands (quicksand?) of a mountain of debt illusion and their currency is backed by nothing but empty platitudes and is in a clear downtrend, foreigners who hold a substantial asset base can only become increasingly alarmed at the attempts to devalue their holdings. For years this scenario has been playing itself out usually unnoticed by most although occasionally as we saw in the 1998 Asian currency crisis it rears its ugly head with the potential for a financial earthquake.

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the bear market that has not left us since it started in 2000 we will see record lows. The drop will be precipitated by a US Dollar crisis and that means that stocks and bonds will fall but gold and gold stocks will soar. And finally despite the recent capture of Saddam Hussein the terrorist attacks will not stop and the risk remains for an event in the US. Be wary of 2004.

David Chapman of Union Securities Ltd. 69 Yonge Street, Suite 600, Toronto, Ontario, M5E 1K3

POST-IT NOTES: THE WALL STREET JOURNAL YEAR-END REVIEW

The dollar finishes dreadful year; Clouds remain.
The Dollar limped to the finish line Wednesday, ending a brutal year in which it weakened to a record low against the euro.
Many observers expect 2004 to bring more challenges for the U.S. currency. Rather than focusing on the economy, currency traders fret about the deficit on the U.S. interest rates that are well below similar rates in Europe and many other parts of the world. Some traders also mention terror threats as weighing on the dollar.
If U.S. interest rates rise and the current-account deficit narrows this year – as many analysts expect-traders say there is likely to be a lag of several months to more than a year before the dollar starts to rally.
“We’re going to see a continuation of the weak-dollar trend in 2004,” says John Taylor, chief investment officer for FX Concepts.

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The fact that it hasn't happened yet is no reason for complacency or even to suggest that it won't happen. It is for these reasons why we remain convinced, amongst others, that ultimately as the world has been forced to in the past when fiat currencies failed that a real asset, gold, will return to some prominence in the world's financial system to once again provide stability.

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The Emperor Has No Clothes

Kurt Richebächer

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The bullish consensus, flatly disregarding the overwhelming hedonic component, immediately hailed the sharp rise in computer investment as the rapid comeback of high-tech investment. Wall Street celebrated with the NASDAQ up 56% since March.

In its absence, nonresidential investment remained dead in the water across the board.

Dr Kurt Richebacher
thedailyreconing.com

POST-IT NOTES:
THE WALL STREET JOURNAL YEAR-END REVIEW

Major Commodity markets rose for a second straight year in 2003, as recovering economies world-wide required ever greater amounts of raw materials to churn out finished goods for consumers. The U.S. dollar's plunge against major foreign currencies made raw materials priced in dollars inexpensive in overseas markets, encouraging U.S. exports. China was a voracious buyer of several U.S. agricultural products. Among the winners: Soybean prices soared more than 40%, to near multiyear highs. Gold crossed the threshold of $400 a troy ounce for the first time in more than seven years. Natural gas surged ahead in the fourth quarter.

As 2004 begins, prices for most commodities seem poised to continue higher. Most foreign-exchange traders expect the dollar to stay weak, prolonging its bullish effect on commodities. Gold, which has soared ever since the September 2001 terrorist attacks, continued to rise in 2003, confirming its traditional role as an investor safety net during times of uncertainty. Other precious metals followed, while copper led industrial metals higher, strengthening along with the U.S. economy.

Gold Futures jumped $67.90, or more than 19%, to 416.10 an ounce in the most-active February contract on the Comex division of the New York Mercantile Exchange.

Frank Holmes, chairman and chief executive officer of U.S. Global Investors, which manages several gold-oriented mutual funds, said Wall Street analysts are out of touch with average investors' lingering discomfort with "paper assets" spurred by the Internet-company crash, terrorism, war and the weak currency. He believes investors will continue to flock to gold as a tangible store of value-a common argument put forward by "gold bugs" – and gold could gain 17% or so more in 2004, to about $500. "Wall Street has been calling for the gold rally to end for the last two years now – ever since it began, really," said Mr. Holmes. "But it just keeps going."

Some of the market's big players have quietly jumped on the gold bandwagon along with everyday investors. One indicator of that, said veteran gold trader George Gero, is that the number of gold futures and options outstanding recently topped one million contracts for the first time at Comex. "That means the hedge funds [lightly regulated investment pools designed for wealthy individuals and institutions] are getting involved in a big way in this market," said Mr. Gero, senior vice president at Legg Mason Wood Walker Inc. "That's ….. a really bullish sign for the metal."

Other metals also did well in 2003. Silver futures rose $1.153, or 24%, to 5.965. Platinum, which continues to be in short supply, jumped $210.90, or more than 35%, to $805.30. But palladium, a component in automobiles catalytic converters, dropped 17%, or 40.50, to 197.50 an ounce, as platinum became a substitute in the emissions-reducing car parts.

Copper leapt 34.3 cents, or 49% to 1.0455. At the London Metal Exchange, Aluminum rose $244.75, or 18%, to 1,588.75 a metric ton. Zinc jumped $254.75, or 34%, to $1,003.75 a metric ton.

Editor's Note: Until next time…. happy investing and thank you for allowing us to service you – Nancy Villa

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